

THE
ECONOMY & FINANCE
OF THE WAR



A DISCUSSION
BY
A. C. PIGOU
ON THE REAL COSTS OF THE WAR AND
THE WAY IN WHICH THEY SHOULD BE MET

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BEING A DISCUSSION OF THE REAL COSTS
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BY

A. C. PIGOU, M.A.

PROFESSOR OF POLITICAL ECONOMY IN THE
UNIVERSITY OF CAMBRIDGE

Author of

*"Wealth and Welfare," "The Principles and Methods of
Industrial Peace," "Protective and Preferential
Tariffs, &c.*



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PREFACE

THE greater part of this little book is constructed from material used in two public lectures delivered in Cambridge under the titles "The Economic Costs of the War" and "The Distribution of the Costs of the War." Some of the topics treated in it are also discussed in articles which I contributed to the *Contemporary Review* for December 1915 and April 1916; and a few passages from these articles are, with the kind permission of the Editor, reproduced *verbatim*. To obviate misunderstanding, it may be well to say that, while the general lines of analysis here set out would probably be accepted by most competent economists, I should not venture to claim an equal measure of assent for all the practical recommendations.

A. C. P.

March 1916.

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THE ECONOMY AND FINANCE OF THE WAR

i. INTRODUCTORY

IN setting out to discuss some of the economic problems connected with the war, I wish to make one preliminary remark. When any one undertakes to write a book about anything, he is usually supposed to consider that thing important. Compared with what this war has cost and is costing in values outside the economic sphere—the shattering of human promise, the accumulated suffering in wounds and disease of many who have gone to fight, the accumulated degradation in thought and feeling of many who have remained at home—

“the storm,
The darkness and the thunder and the rain”

of war—compared with these things the economic cost is, to my mind, trivial and insignificant. But, trivial as it is from this larger standpoint, the fact remains that many people frequently talk about it, and a smaller number occasionally think about it. It is, therefore, desirable that we should try to do these things in a spirit as cool and scientific as the stress of the time will allow.

2. THE MONEY COSTS OF THE WAR

IT is convenient at the outset to define the precise scope of my inquiry. The war involves a number of costs of an economic kind which do not enter into the purview of the Chancellor of the Exchequer or into his budget figures. A nation at war, in fact, suffers large costs over and above those which it has to meet through its Government. For instance, in a country invaded by an enemy an enormous amount of private property is destroyed in the actual operations of war. In a country like our own, which is not invaded, great losses may be inflicted upon many people through the interference with foreign trade which war involves. Furthermore, when men are killed or maimed, the economic value of these men to the country's future productive power is, in the one case wholly, in the other partially, destroyed. Some economists have made estimates as to what they consider the economic value of the average soldier who is killed may be ; and, on this basis, have calculated the economic costs to the country that are involved in the casualty lists. These costs are, in a sense, economic costs.

I have no quarrel with the practice of so calling them. But they are not among the costs which I propose to discuss in this book. What I am concerned with are the costs that come into relation with governmental expenditure and the Chancellor of the Exchequer's budget. Concerning these costs the dry bones of money fact can be set out very shortly. During the year 1915-16, ending in March, it is estimated that the United Kingdom will require and will spend for the special purposes of the war—including loans to allies and others—a sum over and above her normal revenue requirements of about 1300 million pounds. If the war continues for another year beyond March 1916—an event which may Heaven forfend—the amount required for that year will be even larger—over 200 millions larger—than the sum required this year. Those are the money facts—the text for this discussion. My object is to try to throw a little light on what they mean and imply.

3. THE REAL COSTS OF THE WAR

THERE are some people still to be found who believe that the 1300 million pounds, of which I have spoken, actually *constitute* the sum of real things absorbed and used up in the war during the current year. They conceive these things to be really and essentially so much money, and they periodically confide to the public press the suggestion that, if only the Government would create 1300 million one-pound notes, the whole problem of providing for our war needs would be solved. Of course, the truth is that the 1300 million pounds do not *constitute*, but only *represent*, the real things absorbed in the war. When we say that the war uses up 1300 million pounds, what we mean is that it uses up 1300 million pounds' worth of things—of services rendered by men, machines, and materials. These are the real things absorbed in the war, and it is over these, through the symbol money, that the Government needs to get command. This point is too obvious to need any further discussion. We may, therefore, pass at once to inquire in closer detail in what the real things that are thus absorbed principally consist.

They include, of course, first, the services of the men engaged in the army and navy, whether at the front or in reserve or in training. They include, secondly, the services of the people, the machines and the materials employed in the manufacture of munitions of war. They include, thirdly, the services of the ships and railways and motor cars and carts, and of the people working them, that are employed in transport work connected with the war. They include, fourthly, the whole of the organisation, material and human, that has been built up for dealing with the wounds and disease of the war. They include, fifthly, such extra equipment in respect of clothing and of food as is required for persons engaged in war services over and above what would have been required for these persons in ordinary times. They include, lastly, a large mass of things of the same general character as the above and amounting to an aggregate value of some 430 million pounds, that we have contracted to lend during the year to our colonies and to foreign nations which are or might be our allies.

It will have been noticed that I have been speaking so far of things *absorbed for use* in the war. But the things absorbed for use in the war and the real costs of the war to the nation are not exactly identical.

If there had been no war, the great bulk of the things that are absorbed in it would not have come into being at all. The particular sorts of service which soldiers and munition makers render would not have been rendered. The real costs of the war to the nation, then, consist, not in the things that are actually absorbed in the war, but in the things—including the leisure of some of its workpeople—*which the community has to do without in order that these things may be provided.* The real costs to the nation of making a million shells are not the services by which the shells are actually made, but the services which the men and machines who make them would have rendered if there had been no war. At first sight it may be thought that this distinction is merely formal and academic. As a matter of fact, however, it is, as will presently appear, of great practical importance.

4. SOME FALLACIES CONCERNING THE NATURE OF THE REAL COSTS

WHAT has been said completes the direct analysis which it is necessary to undertake concerning the nature of the real costs of the war. In order, however, that the matter may be fully understood, it is desirable to draw attention to certain fallacious opinions on the subject which have a fairly wide currency.

The first of these concerns the relation between the costs of the war and the amount of the national income as it stood before the war. The costs of the war are represented by 1300 million pounds: the normal national income as it stood before the war was, according to the best estimates, represented by 2300 millions. Therefore, the popular argument runs, the goods and services that make up the costs of the war during the current year amount to about thirteen-twenty-thirds of our pre-war national income of these things. This estimate is incorrect, because it ignores the fact that, since the outbreak of war,

general prices in England have risen till they are now some forty per cent. higher than they were in the previous peace. To allow for this change of price level, we ought no longer to represent the pre-war income of real things which has to be set against the 1300 million pounds of war costs by the figure 2300 million. We ought to represent it by a figure raised in some rough accordance with the rise in general prices. The proportion of our real pre-war income embraced in the Government's war demand should, therefore, be put, not at thirteen-twenty-thirds, but, say, at thirteen-thirtieths of the whole.

The second fallacy is as follows. The facts, as I have just stated them, may be granted. But, it is urged—and this is the fallacy—not only do we have to provide goods and services to the tune of 1300 million pounds, but we have to provide them out of a real income enormously diminished. If the real income we had before the war is, at the present price level, rightly represented by 3000 million pounds, now, when over 3,000,000 men have been withdrawn from industry for the army and over two million more for munition work and other duties outside the field of ordinary productive employment, it must be enormously less than that. Thus, the 1300 million

pounds' worth of goods which we have to provide for the war, while it amounts to thirteen-thirtieths of what our income was before the war, must amount to a very much larger proportion than this of the income which the war has now left to us. The real costs of the war to the nation consist, on this view, not merely of the 1300 million pounds' worth of goods, but of this sum *plus* all the services which the soldiers, munition workers and others would, if there had been no war, have provided towards the general real income of the country. This view has been countenanced—I do not say it has been endorsed—by at least one writer who is supposed to be a high authority on financial matters. It is a very gross fallacy. If five million men are withdrawn from ordinary industry for the service of the State, it is proper to say *either* that the community (considered as separate from its Government) has lost the services of five million men, *or* that the community (considered as including its Government) has transferred the services of five million men from private to public uses. But, if we say *both* that the community has lost the services of five million men *and* that it has transferred the services of five million to government purposes, we are using the term community in one sense in the first clause and in a

different sense in the second clause, and are, in consequence, counting the same thing twice over. The point can easily be illustrated from private life. If a man with an income of £2000 spends £1000 on a motor car, we can say *either* that he has devoted £1000 of his income to this purchase, *or* that his income has been reduced by £1000 through this purchase. But it would be a ridiculous blunder to say that he has *both* devoted £1000 of his income to buying a car *and* has also reduced his income by £1000. If we say that he has devoted £1000 of his income to the car, we must envisage the income from which he has taken this sum, not as an income already reduced to £1000, but as one standing at its normal level of £2000. In exactly the same way we must envisage the income from which the nation is asked to devote any given number of millions to war purposes as its normal unreduced income of 2300 millions—or, allowing for the high level of general prices, of 3000 million pounds: and this without reckoning for the fact that a great amount of work is now being done by people who, before the war, were not employed, or were not fully employed, in industrial operations.

The third fallacy is that, when the size of the army is given, the costs of the war to the nation may be

made greater or less according as the rate of pay to the soldiers is high or low, and according as a large or small amount of money has to be paid in respect of their dependants. For example, it is often regarded as self-evident that Germany can conduct the war more cheaply than we can, because her soldiers, being conscripts, receive a merely nominal rate of pay—a very much lower rate than ours do. Again, it was and still is believed by most newspaper writers that, because married men have dependants to whom separation allowances must be paid when the men go to the army, whereas, in general, single men have not such dependants, a married soldier involves much more real cost to the nation than a single soldier. I should not be surprised if ninety per cent. of the people of this country believe this line of argument to be valid. But, if, as I have shown, the real cost of the maintenance of an army, so far as the soldiers are concerned, consists in the productive services which these soldiers would have been rendering in industry if they had not been mobilised, it is plain that the rate of pay given to them does not directly affect the real costs of the war to the nation in any degree. If more is paid to them than they would normally earn, a certain transference of resources is made from the

rest of the community to them ; if less is paid to them than they would normally earn, a certain transference is made from them to the rest of the community. The aggregate real costs to them and the rest of the community combined, that is to say, to the country as a whole, is the same in either case ; it is equal to the sum of the productive services which they would have rendered if the world had remained at peace.

The fourth and last fallacy is closely connected with the one of which I have just been speaking. In the denunciations in which newspapers indulge about the extravagance of the Government in the conduct of the war, every form of alleged extravagance is lumped together under the same head, and it is assumed without inquiry that in every case alike the face value of the extravagance represents the real cost that it involves to the nation. For example, the alleged extravagance of continuing to pay £400 a year to members of Parliament, of paying £1200 to a distinguished Cambridge man and ex-minister for translating extracts from German papers, of paying exorbitant and ridiculous prices to contractors, of paying exorbitant and ridiculous wages to work-people, of taking troops to some place at heavy cost and then taking them back to the place from which

they came, of making immense quantities of a certain kind of shell which is afterwards found to be useless—all these things are supposed to be exactly similar in character and effects. This is a fallacy. From the money standpoint of the Treasury, it is, of course, true that they stand upon the same footing. They all deplete the Government balances and make necessary the raising of more money. But, from the standpoint of the community as a whole, they comprise two quite disparate kinds of extravagance, the effects of which are wholly different. To make masses of shells of a kind that we do not want is a real waste of capital and labour : to transport troops from Egypt to the Dardanelles and then to transport them back again, because the ships were not properly packed, is also a real waste. But to pay a man, whether he be a member of Parliament, or a contractor, or a workman, much more than his services are worth, that, undesirable though it may be, does not involve any waste of national resources. It is merely a transference of resources to one set of people in the country—of course payments made to foreigners are different—at the expense of another set. Since in war time much extravagance and mismanagement *must* occur, not all of which can possibly be stopped, it is the more

desirable that both the authorities who have money to spend and the people who criticise their spending should be able to distinguish between forms of extravagance which do, and forms which do not, really deplete the resources of the community.

5. THE EFFECT ON THE REAL COSTS OF THE WAR OF THE WAY IN WHICH INDIVIDUALS ECONOMISE

I TURN now from matters of an elementary character to a problem which presents greater difficulties. It will be remembered that the Chancellor of the Exchequer's 1300 million pounds are expended in the purchase of certain goods and services which are actually absorbed in war, and that the real costs of the war are made up of the goods and services which the community has to go without in order that these goods and services may be forthcoming. The problem is slightly complicated by the fact that, as everybody knows, it is possible, up to a point, for the British Government, even in war time, to borrow resources from foreigners on the collective security of the national credit. In this war, however, largely because of the immense area involved in it, that device is only practicable to an extremely limited extent. The main part—very nearly the whole—of what is required must be raised in one way or another, either through loans or through taxes, from the people of this country. For the present purpose, therefore, we need not trouble about the Chancellor's fifty million loan in New York or the foreign sub-

scriptions to the war loans issued in England, but may confine attention to the resources raised from taxes and domestic loans. By a combination of these two methods, the Government collects the sum of 1300 million pounds and expends it in the purchase of war services. The 1300 millions, therefore, represents, in a sense, *both* the things actually absorbed in the war *and* the things sacrificed by the community in order to provide them. It, therefore, seems at first sight that, when the amount of things actually absorbed is given, the amount of things that have to be sacrificed—the real economic cost to the community—is thereby rigidly determined. In whatever way individuals decide to make provision for the money they have to hand over in loans or taxes, the aggregate amount of this real economic cost appears to be a fixed thing, wholly independent of their proceedings. Hence, apparently, so far as the *amount* of the economic costs of the war is concerned—I am not now concerned with its distribution—it does not matter at all in what direction the individuals who have to make payments to the State choose to economise their resources in order to do this. That view, it will be generally agreed, is a very plausible one. But it is incorrect. The amount of the real costs which lie behind the Chan-

cellor's 1300 millions *can* be affected in a large and important measure by the policy which individual tax-payers and subscribers to War Loan elect to pursue.

In considering this matter we may, at the outset, rule out as irrelevant to our problem two methods of providing funds that are likely in fact to be practised on a considerable scale. I mean cutting down pensions or the wages of people whom we continue to employ, and borrowing from banks. These methods are irrelevant because they are not really methods of providing resources at all ; they are methods of shifting the burden of providing resources on to other people. In the case of pensions and wage-cuts this is obvious. If I stop a pension of thirty pounds a year to an old servant in order to pay my extra taxes, I myself make no sacrifice either of consumption or of savings. The sacrifice required is shifted away from me on to her, and the problem of how best to make it is similarly shifted to her. In the case of borrowings from banks, what really happens is less apparent to the casual glance, and to explain it in detail would take time. But, in fact, the effect is the same as in the case of cutting down pensions. The task of meeting the State's requirements is not faced by

this device ; it is simply transferred to the shoulders of other people.

Furthermore, there is another reflection on these lines to be added. If a man meets his loan payments or his taxes by cutting pensions or by borrowing, he transfers the whole of the burden. If he meets them by reducing his consumption of commodities on which duties are levied, he, in exactly the same way, transfers a part of the burden. For example, suppose that he reduces his consumption of tobacco and wine and tea and sugar, and, with what he saves by doing that, pays his dues to the Government. We will suppose that the saving he effects on these forms of expenditure and the addition made to his income tax and War Loan contribution are both sixty pounds ; and we will suppose further that, on the average, one-third of the price of the things that he has stopped consuming was due to the customs duties laid upon them. The net effect of his action then is not to increase his contribution to the Government by an extra sixty pounds ; it is, with one hand to add that sum to his contribution, with the other hand to subtract from his contribution one-third of that sum, namely, twenty pounds. He has really shouldered forty pounds out of the sixty pounds burden, and has transferred the other

twenty pounds by making it necessary for the Government to impose extra taxes to that amount on somebody else. I do not, of course, mean to suggest by this that people ought not to reduce their consumption of dutiable articles. If a person does this and takes up War Loan, he, in some measure, helps the State to finance the war. What I do mean is that, if he has decided to help the State to the extent of a sixty pounds burden borne by him, after he has contributed sixty pounds saved in respect of these dutiable articles, he will need, in order to fulfil his resolve, to contribute twenty pounds *more* saved in respect of articles that are not dutiable.

This preliminary matter being disposed of, we now concentrate attention upon those persons who actually shoulder the burden of war charges that is laid upon them—similar reasoning will, of course, apply to persons to whose shoulders a burden is *transferred* by others—and we inquire in what way their conduct can affect the aggregate amount of real costs which the war involves. The State requires from me a contribution in tax and loan that will enable it to buy goods and services represented by a value of, say, 1000 pounds. By handing over that 1000 pounds, in whatever way I provide it, I lose and do without, whether for consumption or

for investment, goods and services valued at that amount. That happens whatever I do. The Government gets 1000 pounds' worth of things and I lose 1000 pounds' worth of things. But—and this is the point—though both what the Government gets and what I lose are approximately fixed, the real income left to the general public—the things that they are able to buy with their money income—is not fixed, but is liable to be seriously affected by the policy which I choose to adopt. I can so arrange things that no incidental burden whatever is thrown upon them; or I can so arrange things that they suffer an additional loss of real income practically as large as that suffered by me. This difference can be illustrated by two extreme cases. First, suppose that I am accustomed every year to buy 1000 pounds' worth of shells and to explode them for amusement on the front lawn of my College. To provide the money for my loans and taxes I dispense with this luxury. The Government then spends the 1000 pounds it gets from me in buying those very shells which I should normally have bought. The whole of what has happened has been that a given mass of shells is transferred from my ownership to the ownership of the Government: nobody else is affected at all. Secondly, suppose

that I am accustomed to spend 1000 pounds in purchasing the most marvellous hand-made lace manufactured by a person who is unable to do anything else whatever except make that lace. To provide the money for my loans and taxes I dispense with *that* luxury. What is the effect of that? My own loss—I assume the two luxuries to occupy about the same position in the general scale of my wants—is substantially equivalent to what it was in the case of the shells. But the position of the public is quite different. My lace-maker cannot transfer her services to the Government. *Ex hypothesi* she can do nothing except make lace which I alone can absorb. She is, therefore, thrown completely idle and her services are simply annihilated. The Government spends its thousand pounds in inducing other people to make shells and so withdrawing them from work on behalf of the civil community. In this case then the 1000 pounds' worth of services which the Government gets is balanced, not only by 1000 pounds' worth of services lost by me, but also, over and above that, by a further 1000 pounds' worth of services lost by the general public. Whether I economise in shells or in this peculiar and marvellous lace, what the Government gets is much the same. But, in the one case, the general public

outside myself loses nothing ; in the other case it loses services valued at 1000 pounds.

So much for my two extreme illustrations. Let me now state the general principle implied in them. When I diminish consumption or investment to the extent of 1000 pounds in order to pay that sum to the Government, I release from employment in my interest the services of men and of machines that have for me that value. If these men and machines are of such a sort that they have for the work required by Government an equal value, no extra real burden is thrown on the general public. If they are of such a sort that they have for the work required by Government no value, an extra burden equal to the whole 1000 pounds paid by me to Government is thrown on the general public. More generally, to whatever extent the value of the services which these men and machines can render to Government falls short of the value of the services they can render to me, an extra burden over and above the burden that I bear is thrown upon the general public. In other words, the real costs, which are symbolised by the 1000 pounds taken by the Government from me, embrace services previously enjoyed by me to the value of 1000 pounds, together with services previously enjoyed by other people to the value of

the difference between 1000 pounds and whatever sum the services dispensed with by me are worth to a Government engaged in war.

That is the principle of the thing. It remains to set out its practical implications. These may conveniently be considered in two divisions, according as they affect our purchases of direct personal services or our purchases of commodities. Let us consider them in turn. First, it is quite plain that, in present conditions, the services of doctors, of men of mechanical knowledge, of chauffeurs, and of young able-bodied men fitted for military service and not possessing any specialised skill are quite as valuable to the Government as they are to private employers. On the other hand, the services of lawyers, of highly-skilled gardeners, of poets, of men learned in the ancient languages, of musicians, of young men medically unfit or with conscientious objections to combatant service, of midwives, of women with special skill as children's nurses, of ballet dancers and of music-hall artistes are much less valuable to Government than they are to private employers. Therefore, other things being equal, if we have to choose between dismissing our chauffeur and dismissing our elderly gardener, who knows all there is to know about orchids, we should dismiss

the chauffeur. If a University has to choose between dismissing its professor of mechanical sciences and its professor of Chinese, it should dismiss its professor of mechanical sciences. If we are in doubt between the excitement of an operation on our appendix and the excitement of an expensive law-suit, we should do without the operation. If our nursery maid is an indifferent nursery maid, but likely to prove a genius in making munitions, we should dismiss her ; whereas, if she is a genius in the care of infants, but material objects, when she touches them, are apt to "come in half in her hand," then we may justifiably retain her services. For, by dismissing her and paying our taxes with the savings so made, we should cause the aggregate real costs represented by our taxes to be much larger than they would be if we had dismissed somebody who was capable of rendering to the Government services approximating more closely to those that he or she was capable of rendering to us.

Secondly, consider our purchases of commodities. The first and most obvious thing to say in this connection is that, since the services of ships are urgently needed by Government, there is a strong *prima facie* case for affecting our economies in respect of goods that have to be imported from abroad, rather than

in respect of goods which are made, and the raw materials for which are made, at home. A similar remark applies to things a large part of the value of which is made up of the cost of transport by rail—such things, for example, as coal. Next, there are certain commodities which are wanted by the Government in exceptionally large quantities for the use of the troops—things such as meat and petrol. Next there are certain commodities which are made by the same kind of machines and work-people as are required for making things of high military need. These commodities will include the products of engineering works, such as motor cars and the plant required for setting up new factories. All such things are obviously suitable objects for private economy. By paying loans and taxes out of savings made in respect of them, we hand over to the Government a value which is approximately as large as the costs which we and the public jointly submit to in providing it. On the other hand, there are a number of commodities which are not useful for war purposes, and which are produced with the help of a large existing plant not useful for war purposes. Such things are obviously, in comparison with the others, unsuitable objects for private (or public) economy. Among them is included

water, as supplied by a water company to a town, and, in a lesser degree, gas and electric light. There are also included the services rendered by museums and art galleries. In these institutions, with their collections, there is embodied an enormous capital plant, quite useless or nearly useless for rendering war service. If they are shut down and the saving in respect of their staffs is utilised by the State, the receipts of the Government are measured by this saving, but the real costs to the public include, not only the services represented by this saving, but also the services of the capital establishment of these institutions, the loss of which is balanced by no corresponding gain to the Government.

At first sight it might seem that the preceding analysis exhausts the topic indicated in the title to this section. In reality, however, there still remains something to be said. Hitherto, I have supposed the choice open to a tax-payer or subscriber to War Loan to lie between dispensing with different sorts of services, which have an equal value to himself, but which, if made available for Government, would have for them various values. It has now to be observed that the choice before him is somewhat less simple than this. For let us suppose that our tax-payer or loan-subscriber is in doubt between

economising 100 pounds in two alternative ways, the adoption of either of which would release for the use of Government services of exactly equal value to them. In such a case one is naturally tempted to conclude that the aggregate real costs of the war must be affected in exactly the same manner by the selection of the one or the other of these economies. This, however, is not necessarily so. The reason is that the conditions of production of some commodities and services are such that a reduction in the amount of them that is consumed diminishes the real cost per unit of providing them. By economising in respect of things of this kind, we enable ourselves and other people to obtain so much of them as we continue to consume at the cost of a diminished expenditure of the nation's capital and labour. In this way we set free for other forms of production some quantity of capital and labour over and above that which used to be employed in producing that part of the commodity or service which we have ceased to consume. The product of this released capital and labour must, therefore, be set on the credit side of the national balance sheet, thus indicating a corresponding diminution in the real costs of the war.

Even in normal times the production of staple

food products and raw materials is apt to be conducted in conditions such as I have described. In technical language, the production of these things is subject to diminishing returns, and it is a commonplace of economic theory that economy in the consumption of them on the part of those who can afford it is, in all circumstances, socially advantageous. In the special circumstances of war, however, when certain classes of goods are required in exceptional quantities with such urgency that an organisation appropriate to the new demand has not yet been built up, the range of commodities and services affected by conditions of diminishing return, and the intensity with which these conditions operate, are much greater than usual. There is, thus, considerable scope for a selection, along these lines, of economies that will react more favourably than others upon the aggregate mass of the real costs of the war. Economies in bread, meat, sugar and petrol have obvious advantages in this respect. So also—and the argument is not injured by the fact that this category overlaps with one already employed—have economies in respect of the general body of imported goods, because a reduction in the amount of *any* sort of import tends to reduce freights, and freights are a part of the cost of *all* sorts of imports.

6. GOVERNMENTAL INTERFERENCE WITH THE WAY IN WHICH INDIVIDUALS ECONOMISE

THE discussion of the preceding section has made it plain that individual tax-payers and subscribers to loans can materially affect the amount of the real costs of the war by the way in which they choose to make provision for their payments to the State. Evidently, then, their personal duty is to direct their economies into those channels which affect these real costs most favourably. About this there need be no difficulty or dispute. But a more complicated question is raised when it is asked whether the Government ought, by fiscal or other measures, to enforce the performance of the above duty; for the fact that the country will be advantaged if a man does something voluntarily does not necessarily imply that it will be advantaged if the State attempts to make him do it. Nevertheless, there is clearly a *prima facie* case for the imposition of high taxes for the period of the war upon commodities in respect of which economies are more than usually advantageous. Special duties upon petrol as used

in private touring cars, and general duties upon imported goods other than those of prime necessity have, therefore, not unnaturally, many advocates. There are, however, two serious difficulties in the way of any widely-extended use of this device, and both these difficulties demand close attention.

The first of them has to do with the fact of substitutes. When a commodity serves a purpose which people are fairly ready, at need, to leave unsatisfied—in technical language when the demand for the satisfaction of that purpose is fairly elastic—the effect of putting a tax on the commodity will always be to release capital and labour from employment in the interests of that purpose. In these circumstances, therefore, the tax will achieve its object. But, if the commodity serves a purpose which people will not relinquish readily—the demand for the satisfaction of which is inelastic—the effect may be quite different. In so far as they continue buying the commodity as before and paying the tax upon it, nothing happens beyond a transference of resources from them to the State, and, from the present point of view, neither harm nor good is done. It is, however, often the case that a purpose can be served, not only by the commodity which normally serves it, but also by some alternative

commodity which can do the same thing somewhat less effectively. In these circumstances, unless taxes are imposed on all the alternative means of satisfying the purpose in question, the imposition of a tax on one among them may cause people, not to stop satisfying the purpose, but to satisfy it in a different way at a cost of capital and labour which is actually greater than before. Herein is a serious objection to such a piecemeal policy as the closing of museums and art galleries. May not the result be merely an expansion in the services which the public demand from picture palaces and public houses? Herein, too, is the great difficulty in the way of import duties unaccompanied by corresponding excise duties. Instead of causing people to employ less capital and labour in respect of the needs they used to satisfy by importation, the imposition of such duties *may* cause them to satisfy these needs through the manufacture of identical or similar things in a more expensive manner at home. Any attempt to utilise fiscal machinery to direct individual economy into advantageous channels must be executed with very great care if it is to be successful in meeting this class of difficulty.

The second difficulty is equally important. It is obvious that the imposition of a tax of any given

amount upon a commodity will be a much more serious matter to a poor man than to a rich man. An increase of price, which may make little difference to the amount consumed by the rich, may place a commodity wholly outside the poor man's reach. It may well be, however, that a poor man, who normally purchases a small quantity of something, satisfies thereby more urgent needs than are satisfied by some part of the larger purchase of a rich man. In so far as this is the case, the imposition of duties is a very clumsy method of bringing about economies. It checks consumption a great deal on the part of people among whom a check causes most suffering, and only checks it a little where a large check would be easily borne. The inevitable inference is that, apart from administrative difficulties, a policy of "rationing," such as the German Government has attempted to initiate, is greatly preferable to a policy of duties—at all events in respect of articles that form a part of the staple food of the poor. Such a policy cuts down consumption in the right place, namely, where it is a relatively unimportant contributor to well-being. Rationing, however, is obviously impracticable except over a somewhat narrow field of commodities. Furthermore, the difficulty against which it is designed to guard is

not of great importance except in regard to mass goods of general consumption. What has been said, therefore, must not be taken to imply that there are no cases in which duties upon particular commodities may be usefully employed as an instrument for directing the economies of the community into socially advantageous channels. It does imply, however, that such duties are a two-edged weapon, the successful wielding of which demands knowledge and skill.

7. FUTURE RESOURCES AND PRESENT RESOURCES

UP to this point attention has been concentrated upon the amount of the real costs of the war. We have now to observe that the people upon whom these costs are imposed have it in their power to draw them from either of two broad groups. These are, respectively, future resources and present resources. The choice between them, which individual tax-payers or subscribers to War Loan make, determines how far the real costs of the war are borne by the present generation and how far they are thrown upon future generations. It is, therefore, desirable to consider in some detail in what the two groups of resources thus distinguished principally consist.

To draw upon the future for war purposes means to trench upon actual or potential capital, thus leaving current income intact but reducing the income of after years below what it would otherwise have been. The ways in which this can be done fall into two divisions, one dependent upon the maintenance of communication with the outside world, the other available for all countries. Each

of these divisions may in turn be separated into several sub-groups.

Of the ways dependent upon the maintenance of communication with the outside world, the first and most obvious is the selling abroad in exchange for immediate income of existing stores of capital goods. It is conceivable that even such things as land, houses and reservoirs might be made use of in this way ; for, though they could not be taken out of the country, there is nothing, either in the nature of things or in the law of the land, to prevent them from being sold to rich Americans in their present sites. Practically, however, for the purpose of obtaining resources in a hurry—and, of course, the essence of our war needs is urgency in point of time—this resource does not amount to much. The capital goods that can be effectively utilised by sale abroad are confined, broadly speaking, to those which are capable of physical export, namely, jewellery, works of art and gold and silver bullion. By the sale of these things in neutral countries, a considerable fund of real income could, no doubt, be obtained.

The second way is the selling abroad of securities held by Englishmen in foreign enterprises. It was estimated before the war that English holdings of

such securities amounted to some 3500 million pounds, of which perhaps 600 millions were derived from American railways. In practice, in the present world war, New York is the only market in which any large amount of securities can be disposed of, and New York is not ready to buy non-American stocks and shares. Even so, however, it is evident that, at the beginning of the war, citizens of the United Kingdom had in their foreign holdings a very large quantity of realisable resources. There is reason to believe that some use has already been made of these, and that an appreciable proportion of our American securities has already been sold. There can be no doubt, however, that large holdings still remain in our hands.

Of the ways of drawing upon the future that are available for any country, whether or not the means of communication with other countries are kept open, the one that naturally suggests itself first is the direct utilisation within the country of portions of its capital wealth. This wealth, it is said, in the case of the United Kingdom, amounts to about 15,000 million pounds; a sum so immense that, by resort to it, we could, if we chose, finance the war for a very long time. But this point of view ignores the fact that the capital wealth, which is

valued at this sum, consists for the most part in such things as the land of the country, the buildings upon it, its railway lines, its reservoirs, and so forth. These things, fixed in space as they are, are obviously incapable of being used directly for any war purpose. The only part of our capital wealth that is capable of being so used consists in the stores of food, of raw materials, and of certain selected finished goods that constitute the customary stocks of shops and warehouses. This way of drawing upon the future is not, therefore, of very great practical importance.

A second way is the drawing out, as it were, of resources from existing industrial plant by refraining from the expenditure required to make good wear and tear and to replace obsolescent machinery. It has been estimated that the aggregate cost of maintenance, in this sense, of the plant of the United Kingdom amounts to some 170 million pounds a year. By allowing plant to depreciate, we have the power, if we choose to exercise it, to add goods and services roughly equivalent to this sum to our provision for the war. It is obvious, however, that very serious after-consequences would result if the depreciation of plant were allowed to go far.

A third way is refraining from new investments.

It has been estimated that, in the ordinary course, Englishmen invest about 400 million pounds a year. A complete stoppage of such investment would, therefore, yield some such sum as that,—or, allowing for the change of price levels, thirty or forty per cent. more than that,—towards war costs.

I now turn to the second of the two main divisions into which ways of meeting war levies are separated, namely, drawing upon the present. To draw upon the present means to leave the income of after years intact and to bear the whole burden at the moment. This can be done in two principal ways, by creating extra income through extra exertions and by economising consumption. There can be no doubt that the device of creating extra income is being resorted to at the present time in very considerable measure, at all events among the poorer classes. Many men are working longer hours and more overtime than usual ; artificial rules designed to restrict output have been markedly relaxed in industries directly connected with the war ; the reports of the Labour Department show that the percentage of persons unemployed is very much smaller than usual ; stoppages of work on account of industrial disputes are very much less numerous ; many women and some men, who were formerly

enjoying a more or less leisured life, have turned to some form of productive labour. What these extra services amount to in the aggregate it is impossible to say, but they are certainly considerable and must involve an appreciable increase in real income to set against the extra costs of war. It is probable that in Germany this resource has been invoked in greater measure than in the United Kingdom; and, if we so desire, it is in our power to make an increased call upon it. The alternative form of drawing on the present is the economising of consumption. The general character of this is obvious and requires no explanation.

To the above analysis one qualifying consideration must be added. Hitherto it has been tacitly assumed that the distinction between drawing upon the future and drawing upon the present is always clear-cut and sharp. In fact it is, in some circumstances, blurred. After we have descended a certain distance along the scale of wealth, a check to consumption or to leisure no longer affects the present alone. It reacts injuriously upon the general efficiency of the people affected, and, hence, strikes indirectly at their future productive power. At a later stage of our inquiry this fact will be seen to have an important bearing upon practical policy.

8. GOVERNMENTAL INTERFERENCE WITH THE CHOICE BETWEEN FUTURE AND PRESENT RESOURCES

JUST as in Section 6 we inquired whether and how far it was desirable for the Government to intervene with a view to directing the choice of individuals between different sorts of economies, so now we have to inquire whether and how far it is proper for them to interfere with the choice that individuals make between drawing on the future and drawing on the present. Before, however, this inquiry can be successfully undertaken, it is necessary to dispose of a wide-spread popular error. Many persons believe that, so soon as the method of collecting money for the State is decided upon, the choice of individuals between drawing upon the future and drawing upon the present is absolutely and finally determined. Whatever part of the cost of war is met by taxes is, they hold, necessarily paid for in the present; while whatever part is met by loans is necessarily thrown upon the future. What has been said in the preceding section should, however, already have made it plain that this opinion is in-

correct. The fact, that, when the Government raises money by a tax, it does not afterwards pay interest, is no proof that the future is not burdened ; for the person who pays the tax may have taken it from funds which would otherwise have been employed in creating productive capital. In like manner, the fact, that, when the Government raises money by a loan, it does afterwards pay interest, is no proof that the future is burdened ; for the person who subscribes to the loan may have devoted to that purpose funds which would otherwise have been used up in immediate consumption. Of course, it is true that, when interest is contracted for, the tax-payers of the future will find themselves mulcted to provide it. But the burden thus thrown upon them is offset by the advantage conferred on those of their fellow-citizens who hold loan-stock and to whom the interest is handed over. The payments made, therefore, afford no evidence of the existence of any *net* burden to the nation as a whole. In short, the question, how far the burden of war expenditure is borne by the present or the future, depends on the choice made by individual contributors to the Government's need of the source upon which they will draw. The notion that the part drawn from the present *must* be equal to the

tax revenue and the part drawn from the future to the loan revenue is without foundation.

Though, however, the Government cannot determine the distribution of war costs between the present and the future in the simple way that popular thought supposes, it can undoubtedly exert considerable influence upon that distribution. Of the indirect influence which is exerted by the policy adopted as regards the proportion of the burden to be thrown upon people of different grades of wealth, I shall speak later on in another connection. But there is also scope for direct influence. Thus, in so far as the Government deliberately impedes consumption by "rationing" the people in respect of articles of food, by forbidding or restricting the importation of consumable goods (or the raw materials of such goods) for which there are no obvious substitutes, and by imposing duties upon consumption generally, it encourages people to meet the demands of war by drawing upon the present. In so far, on the other hand, as it deliberately impedes investment, as it has done by the Treasury Order, which forbids such investment in foreign countries, restricts it in outlying portions of the Empire, and controls it within the United Kingdom itself, it encourages them to meet these demands by drawing upon the

future. These two sorts of policy, therefore, produce contrary effects.

In view of the power which the Government is able to exercise through the above devices and other similar devices which could easily be formulated, it is evidently important to determine what kind of distribution of costs between present and future resources it ought to try to bring about. In the case of the choice between different sorts of economies discussed in Section 6, the conception of the ideal to be aimed at presented no difficulty. Other things being equal, it was obviously desirable that those economies should be encouraged most which tended most effectively to minimise the sum total of real war costs. In the present case, however, the matter cannot be decided in any such general way. Rather, it would seem that the proportion in which the present and the future ought to be drawn upon depends on the detailed circumstances and character of the particular war in which we are engaged. The future ought to be mulcted just in so far as the war is of such a kind that posterity can fairly be asked to contribute towards the cost of it, and the present ought to be mulcted for whatever is necessary beyond this.

The above result is not definite enough to form

the basis of any very confident practical inferences. But it warrants one rough generalisation. Tax-payers and contributors to loans are not likely to underestimate the importance of their own well-being as compared with the well-being of posterity. On the contrary, if they are left to themselves, it is probable that they will draw upon the present less than it is desirable, in the interests of present and future combined, than they should do. Hence, if the Government so acts as to influence their choice in either direction, it certainly ought not to weight the scales against the interest of the future. It certainly ought not to discountenance investment without at the same time adopting at least equally forceful means to discountenance extravagant and unnecessary consumption.

9. THE FOREIGN EXCHANGES

HITHERTO the distinction upon which we have been working is that between drawing upon the future and drawing upon the present. This distinction, however, is not the only one which has practical importance. The costs of the war can be met either by disposing abroad of saleable property—which, for the present purpose, practically means gold and American securities—or by utilising current capital and labour. The choice between these two methods is not equivalent to the choice between drawing upon the future and drawing upon the present. For, on the one hand, if saleable property is disposed of abroad, the future will not be drawn upon in so far as equivalent investment is made in new capital at home; and, on the other hand, if the alternative method is adopted, the present will not be drawn upon in so far as the capital and labour utilised are capital and labour that would normally have produced, not consumable goods, but machines. Hence, the distinction between resort to saleable property and resort to current capital and labour is

a new and independent distinction. The purpose of this section is to examine some questions of importance to which it gives rise. Since, however, as will presently appear, these questions are associated with the general problem of the foreign exchanges, it is necessary, before they are examined, to clear away certain popular misconceptions concerning the meaning and significance of exchange movements.

There is a very wide-spread opinion to the effect that, when the foreign exchanges move against a country in a given proportion, this necessarily implies that the real cost to her (in terms of her own goods) of obtaining foreign goods has moved in the same sense and in the same proportion. This, however, is an error ; and the nature of the error can be illustrated from recent happenings in Germany. The rate of exchange between that country and, say, Holland measures the amount of Dutch money in Holland which people are willing to give in exchange for a claim to a given quantity of German money in Germany. Consequently, when it is said that the Dutch exchanges have moved against Germany, as they have now done, to the extent of some twenty-seven per cent., what is meant is that Dutchmen in Holland are offering

twenty-seven per cent. less Dutch money than usual in exchange for a claim to a German mark, and that Germans in Germany, when they require claims on Dutch money in Holland, have to pay twenty-seven per cent. more marks than usual. If the general level of prices in Germany and also the general level in Holland had remained unaltered, or if both levels had changed in the same proportions, this twenty-seven per cent. fall in the value of German money relatively to Dutch money would necessarily mean also a fall of twenty-seven per cent. in the value of German goods relatively to Dutch goods, and, therefore, an increase of twenty-seven per cent. in the quantity of German goods that Germany had to give in order to obtain a given quantity of Dutch goods. But, if the general levels of prices have not remained constant relatively to one another, this implication does not hold good. For example, suppose that prices in Holland have remained unchanged, but prices in Germany have risen twenty-seven per cent., then the value of German money relatively to Dutch money has fallen twenty-seven per cent., but the value of German goods relatively to German money has risen twenty-seven per cent. In these circumstances, the value of German goods relatively to

Dutch goods is unaltered, and the quantity of German goods that has to be given in exchange for a given quantity of Dutch goods is the same as before. It follows that movements in the money exchanges cannot be used as an index of movements in the real rate of interchange between domestic and foreign produce, until their *prima facie* indications have been reviewed in the light of concurrent price changes. Nor need we be content with this general *caveat*. For a very striking example of its practical importance is immediately at hand. While the value of the German mark on neutral exchanges has fallen over twenty per cent. more than the value of the English pound, prices in Germany have risen some forty per cent. more than prices in England. This implies that the real cost of foreign imports in terms of domestic produce *has risen in a smaller degree in Germany than it has done in England*. This important fact is not realised by those who concentrate their attention upon the money exchanges. But, when we recollect, on the one hand, that England's demand for foreign goods has enormously increased while the war has cut off a large part of the foreign (belligerent) demand for her exports, and, on the other hand, that the import and export branches of Germany's foreign trade have both

been enormously restricted by the British blockade, it is seen to be one that need cause no surprise.¹

There is a second very wide-spread opinion, which a study of the present situation in Germany also suffices to correct. This opinion is that, if the exchanges move against a country to such an extent that a claim held by a Dutchman to an ounce of gold in Germany becomes worth less in Holland than an ounce of gold *minus* the cost of carrying an ounce from Germany to Holland, Dutchmen holding these claims, instead of selling their bills in Holland, will encash them in Germany and export the gold. And the corollary to this opinion is that it is impossible for the exchanges on a country to stand for any long period at a level below the export specie point, without the main part of that country's reserve of gold being drained away from it. In view of the fact that, from a very early stage in the war, the German exchange on neutral countries has stood far below the export specie point, while

¹ To obviate misunderstanding, it should be added that analysis on the above lines cannot by itself yield a measure of the alteration which has occurred in the absolute rate of interchange between English (or German) and neutral goods. In order to obtain such a measure, we should need also to take account of the rise of freights and of the change which has presumably taken place in neutral countries in the relative prices of export goods and of goods in general.

the Reichsbank still possesses an enormous gold reserve, these opinions are evidently in need of qualification. The required qualification is that they hold good only in respect of a country in which the banks allow gold to be taken freely for export in exchange for notes encashed at their face value. Germany was never a *perfectly* free market for gold in this sense, and since the war began, it may be assumed that the Reichsbank has almost entirely stopped the withdrawal of gold for export. In these circumstances, the normal "corrective" of large adverse movements in the exchanges is not at work. There is nothing to prevent a strongly adverse position being permanently maintained in a country which still enjoys the consoling spectacle of a mountainous gold reserve.

The preceding discussion of popular misconceptions was designed to prepare the way for a study of the more special "problem of the exchanges," which the progress of the war has made it necessary for this country to confront. The general situation is sufficiently plain. In normal times the United Kingdom is accustomed to import large quantities of food and raw materials, and to pay for them out of her claims for interest upon loans formerly made by her and out of the proceeds of the sale of current

exports of coal, manufactured articles and shipping and banking services. As a result of the war our demand for imports has enormously increased, on account of our great need for munitions and other foreign goods, both for our own use and for the use of our allies ; while the amount of labour and capital available for making exports to pay for these things has diminished. It is true that the gap thus made between our requirements and our means of payment is partly filled by the utilisation of that proportion of our claims to interest which we were formerly accustomed to devote to capital investments abroad. But, even so, the conditions are plainly such as to make it extremely difficult for us to find means of paying for the enormous extra purchases which we desire to make. These conditions embody two grave disadvantages. First, the great enhancement in the quantity of imports that we demand cannot be provided by foreign sellers except at a considerably increased real price in terms of British goods. Since we want more foreign commodities than before, we are compelled to give (or promise) more of our own exports than before in exchange for a unit of them. Secondly, the shortage of capital and labour available for use in foreign trade threatens to make it *impossible* for us to provide the necessary exports ;

and, if this is impossible, it may also be impossible for us to secure that provision of food, materials and munitions which is absolutely essential to success in the war. Herein lie the real problems of the foreign exchanges. The position of the money rate of exchange with New York, Amsterdam and the rest does not *constitute*, but merely symbolises and represents them.

The most obvious ways in which these problems can receive a practical solution are as follows. We may rigorously cut down a great part of those of our normal imports which are not strictly necessary ; or, we may divert resources from making commodities for home use and turn them into making more commodities for export. Both these ways are forms of meeting war costs by the utilisation of current capital and labour. For, if we cut down unnecessary imports to balance the extra imports of munitions, we are diverting the capital and labour which formerly made exports from the work of indirectly yielding imported motor cars to that of indirectly yielding imported shells : and, if we increase our exports, we are diverting capital and labour from directly yielding consumables and machines for home use to indirectly yielding these shells. The utilisation of current capital and

labour constitutes then one principal way of financing those of our war costs which have to do with imports. Over against this there stands a second principal way, namely, the utilisation of saleable property in the form of gold and American securities. If things are left to take their course, the play of economic motives, acting through movements of prices and movements of the exchanges, will presumably cause resort to be had in some measure to both these principal ways. Some unnecessary imports will be cut off, some capital and labour will be turned from other employments to making goods for export, and some gold and some securities will be sold abroad. The question we have to ask is : is this normal individualistic solution of the exchange problem satisfactory, or is it desirable in the general interest that the Government should interfere to modify it ?

Now, in the inquiry conducted in Sections 7-8, concerning the distribution of war costs between the future and the present, it was tacitly assumed that the choice made between these two sources is not relevant to the actual result of the present war ; and that tacit assumption was, in fact, justified. With the problem now under discussion, however, the case is quite different. For, if, of two nations

at war, both are able to obtain equal resources from the utilisation of current capital and labour, but one is able to obtain more resources than the other by the sale abroad of gold and securities, the effective use of this extra financial power may eventually decide the military issue. It is important to consider the practical inferences which follow from this circumstance.

Though Germany possesses a larger hoard of gold than the United Kingdom, there can be little doubt that our excess of holdings of American securities greatly exceeds her excess of gold. On the whole, therefore, the saleable property which we possess is very much larger than hers. Furthermore, owing to the fact that the British navy is supreme, our saleable property is actually available for exchange against foreign goods, while Germany's saleable property is, in great measure, immobilised and useless. It follows that we have in our saleable property an important element of financial strength to which our principal enemy has no equivalent. To *have* strength, however, and to *make use of* strength are not the same thing. If Englishmen choose to utilise the services of current capital and labour to the same extent as Germans do, England's greater power of selling gold and securities abroad

will constitute an additional resource—a kind of financial reserve—which, if properly employed, should enable her to outlast her opponent. In so far, however, as Englishmen, because they possess this resource, have resort to current capital and labour for war purposes to a less extent than their opponents, they are using up this resource in a way that does, indeed, enable them to conduct the war more comfortably, but does not assist them towards winning it. It has been suggested that we have, in fact, been rendered by our very power more complacent than Germany in this matter. And it has even been suggested that the British blockade of the German coast has really been a blessing to that country, because it has forced her to economise her resources, whereas the freedom from blockade, which the United Kingdom enjoys, has really been injurious, because, by opening up the easy road of selling gold and securities, it has enabled us to be wasteful and extravagant. This suggestion is, of course, an exaggeration and a paradox. But the fact that it has been made serves to emphasise the point which I am endeavouring to bring home. *It is in the national interest that the war should be financed in the utmost possible measure by the utilisation of current capital and labour, and that our sale-*

able property—gold and securities alike—should be rigorously conserved. It is, therefore, right that the Government should prohibit or restrict the importation of articles that can be dispensed with without serious injury—paper, furniture woods, the more expensive fruits, tobacco, barley for distilling purposes, and, it might be added, barley for brewing purposes. It is also right that they should endeavour, by their banking policy and by the Chancellor of the Exchequer's plan for buying or borrowing certain classes of American bonds and stocks, to concentrate the gold normally in circulation and the saleable securities normally held by the public under their own hand and control. But it is not right, except under the stress of grave necessity, that they should use either the gold or the securities to correct the foreign exchanges. The necessary correction—for to maintain the exchanges is necessary, or at least important for England in a much higher degree than it is for Germany—should be accomplished, so far as it possibly can be, by resort to current capital and labour; and the Government should hold grimly, not perhaps to the nation's gold, but certainly to the main part of the nation's foreign securities in spite of considerable difficulty and inconvenience. If they have the fortitude to do this,

they will have at their command, when the critical moment comes, a powerful strategical reserve. By conserving it till then, and then throwing it into the scale, they may, if fortunate and wise, bring about the end of the war.

10. TAXES *VERSUS* LOANS

WE have now to attack the main economic problem of war finance as it presents itself to the politician, namely, the problem of determining how far the Government should finance the war by taxes and how far by internal loans. The sole third plan that is feasible on a large scale—overt manipulation of the currency—being ruled out of court in this country by public opinion, the above two fiscal methods are the only ones that are really available. Some combination of the two the State *must* adopt. What are the considerations which determine the proportion of the total costs which it is right to cover by taxes and by loans respectively? As regards that part of these costs which is required for making loans to allies and others, there is, indeed, no difficulty. The natural and obvious thing for our Government to do is to play the part of an intermediary, handing forward to the Governments concerned resources which it has itself borrowed. But what is the right policy to adopt as regards that other and principal part of our war costs which is not lent to others but is used up by ourselves?

It has been shown in Section 8 that, as regards the distribution of the burden of war costs between present and future, the influence of the Government's choice between taxes and loans is secondary and remote. There is, however, another sense of distribution, namely, distribution between people of different grades of wealth, in regard to which its influence is primary and direct. In order that the question set out at the end of the preceding paragraph may be satisfactorily answered, the exact nature of this influence must be determined.

In a community where everybody was in an exactly similar position and of exactly similar wealth, the effect of a State loan of 1000 millions and of State taxes to that amount would (except in respect of costs of collection) be practically identical. No doubt, under the loan method interest would be paid in the future and under the tax method it would not. But the interest itself would have to be raised by new taxes : so that, if all members of the community were in the same position, the interest that each of them got would be, in effect, paid out of a new tax of equivalent amount levied on himself. A man who had lent 1000 pounds to the State would get, say, fifty pounds a year interest on it ; but, in order to provide that interest, he would himself

have to pay fifty pounds a year in extra taxes. If he had paid his 1000 pounds to the State as a tax, he would get no interest on it, but neither would he have to pay future taxes with which to provide the interest. All this is plain enough. But, of course, this country does not, in fact, consist of a number of people of exactly similar wealth and in exactly similar situations. It consists of some very rich people, some moderately rich, some poor, and some very poor. In view of this fact, the effect of a State loan of 1000 millions and of State taxes of 1000 millions are emphatically not identical. That is the point which has now to be made clear.

It is easily seen that, as a practical proposition, a limit must be reached fairly soon in the amount of resources which it is possible for the Government to take from the poor. The margin available for taxation among them is, both as regards individuals and as regards the poor as a group, small. Consequently, when an immense sum, such as the extra 1300 million pounds needed to finance twelve months of the present war, has to be raised in a single year, it is *necessary* that by far the greater part of it shall be raised somehow from better-to-do people. Furthermore, it is obvious that, generally speaking, as we pass up the scale of wealth, every

increase in an individual's income means, not merely an increase in the available margin of resources, but an increase which grows more than in proportion to the growth of income. If one man is twice as rich as another, other things being equal, his available margin is not twice as large, but more than twice as large. Hence, about one thing there is no choice whatever. Of the money needed by the State the rich man *must* provide in one way or another more than the poor man, and the very rich man more than the moderately rich man ; and the amount provided *must* increase, not merely proportionately, but progressively as wealth increases. This, as I say, is necessary ; and about it there is no opportunity for choice. What there is opportunity for choice about is, how far the extra contribution from the rich and the very rich should be made in the form of loans, and how far in the form of taxation. That is the practical question which Governments in war time are called upon to decide.

What, then, is the difference between the effects of raising 1000 millions from the better-to-do classes by means of progressive taxation and by means of war loans, which will, as a matter of fact, be subscribed in a progressive sense ? As regards immediate effects, there is no difference. These

people provide the money more or less in the same proportion whichever plan is adopted. But, as regards aggregate effects, there is a very great difference. Under the tax method the rich and moderately rich really shoulder the whole burden of the charge that is laid upon them. Under the loan method they do not do this ; because they are compensated afterwards through taxes laid for that purpose partly on themselves, but partly also on other and poorer sections of the community. Under the tax method a great deal of money is obtained from the very rich and the rich of this generation without compensation. Under the loan method the same amount of money is obtained from them, but a contract is appended to the effect that the poorer classes in future generations shall pay money to their descendants as a reward for their present patriotic conduct. That is the vital difference between the two methods. It follows that the root principle, in accordance with which the Government should decide how far to finance the war by taxes and how far by loans, is the judgment that it forms concerning the right ultimate distribution of war costs between people of different grades of wealth.

Having got so far in our analysis, let us look at what actually happens. The general attitude

towards the problem I am discussing may, perhaps, be represented somewhat in this way. The distribution of the expenses—the objective burden—of Government in peace time between richer and poorer citizens is presumed to be reasonably proper. That being so, it is thought, in the face of the immense extra expenses of war time the objective burden upon all of them ought to be increased in about equal proportions, a few extra turns of the screw—but only a few—being applied to the rich, by way of good fellowship and class solidarity. How can this be done? It cannot be done by simply raising taxes on all classes in a sufficient proportion to cover the war needs, because, if that plan were adopted, a great number of very poor and of poor persons would literally be reduced to starvation. But it can be done by another device. The taxes on the poorer classes cannot practically be increased in more than a modest proportion. Let the taxes on the richer classes be increased in a more or less similar proportion. When this has been done, by far the greater part of the enormous war costs will still remain. Let these be raised by loans collected, as in the main they must be, from the richer classes. Since interest on these loans will be paid afterwards out of general taxes, the real

objective burden involved in them will be distributed between rich and poor in the proportion in which the objective burden of general taxes is distributed. It follows that by this device the whole objective burden will be distributed among people of different grades of wealth in the old familiar proportions proper to times of peace—proportions which, according to the view I am now describing, are also proper in the face of the present war. It seems to me—it is difficult, of course, to tell whether one is judging rightly—that, if the general mass of opinion upon this subject could become vocal, it would express itself more or less on the lines of the argument I have just sketched. At all events, what the Government has actually done accords fairly well with the practical conclusion of that argument. In my opinion the argument is incorrect, and the practical conclusion not in the best interests of the country.

With the first stage of the argument—that the distribution of the objective burden of the peace revenue between different sections of the community, as it obtains in ordinary times, is reasonably proper, it would be idle in the middle of a war to quarrel. As practical persons, whatever we may think about it in private, we must agree—under

protest if we will, but nevertheless agree—to take it as the starting point of our discussion. That, at all events, is what I propose to do. But, granted this first stage, what can we say of the second stage—the proposition that the proportionate distribution of the objective burden of the revenue, which is proper in respect of ordinary peace charges, is also proper as regards the expenses of a tremendous war? This proposition is open to a number of very serious objections.

First, it is obviously not valid unless the relative *general* situation of the richer and poorer classes is left substantially undisturbed by the war. If the poor are placed, through reactions indirectly brought about, in a worse comparative position than they occupied before, allowance for this fact ought to be made in the fiscal policy that is adopted. As a matter of fact, there are strong reasons for believing that the comparative position of the poor is adversely affected in a serious degree. To begin with, it is practically certain that a large part of the resources required for war use will be taken in one way or another from funds which would otherwise have become industrial capital. In order to secure these funds, the rate of interest offered by the State will have to be raised considerably above the normal

rate; and this new high rate will thereafter be obtained, not only by those capitalists who invest in War Loan, but also by others who invest new capital in ordinary industry. Furthermore—and this is a point of some importance—the rise in the rate of interest will almost certainly be larger in reality than it is in appearance. The last War Loan was issued at a nominal, or money, rate of four and a half per cent.; that is to say, for 100 sovereigns subscribed now four and a half sovereigns are to be paid annually in future years. But, it has to be remembered, the general level of prices now is about forty per cent. higher than it was before the war, and is probably some such amount as that higher than it will be when the upheaval due to the war has passed away. Consider what that means. Translate the 100 sovereigns of principal and the four and a half sovereigns of interest into terms of real things. Suppose—in violation, it must be admitted, of current market prices—that at present one sovereign buys one sheep. Then an investment of 100 sovereigns is, in terms of real things, an investment of 100 sheep. The interest promised on that is four and a half sovereigns. But, after the war, general prices are going to be, let us say, one-third lower than they

are now. If that is so, one sovereign will mean then, not one sheep, but one and one-third sheep ; and four and a half sovereigns will mean not four and a half sheep but six sheep. That is to say, though the nominal rate of interest in terms of money is only four and a half per cent., the real rate in terms of things is probably something more like six per cent. Thus, the rich stand to gain largely as an indirect result of the war. On the other hand, the poor stand to lose. During the actual progress of hostilities, no doubt, the absorption of a large part of the labouring force of the country into the army must cause the services of those who remain to be in exceptionally keen demand ; and this fact, coupled with the provision of liberal separation allowances by the State, may render the poorer classes, as a whole, fairly prosperous.¹ This prosperity, however, is essentially short-lived. The absorption and destruction in war of large masses of resources,

¹ As regards the actual position of the working classes at the present time, it appears that the *rate* of money wages (including war bonuses) has, on the average, risen considerably less than retail prices. But the allowances paid by the State to dependants, the long hours of overtime worked by many work-people, and the advent into industry of large numbers of women and of relatively inefficient men, who in normal times are either not employed at all or only employed intermittently, have probably caused the real income of the average working-class family to stand somewhat above its normal level.

which would normally have been used in industry, necessarily means that the labour of future years has fewer tools and machines with which to co-operate, is, therefore, less productive, and, therefore, earns a lower real rate of remuneration. The lasting injury thus brought about is almost certain to over-top the temporary benefit. This double fact—the gain to the rich coupled with the injury to the poor—obviously implies a very substantial worsening in the comparative position of the poor.

This, however, is not all. As a matter of practice it is almost certain that, when very large levies are required from the rich, these will not be provided without considerable resort on their part to the device of borrowing from banks. If, as is probable in the case of very large levies, their borrowings for war loans and war taxes, coupled with the War Loan subscriptions of the banks themselves, exceed their normal borrowings in times of peace, there is likely to occur a certain amount of currency inflation. This means that the bank money handed over to the Government and expended by them has reached such a large amount that it causes prices to rise. The result is that the money income held by the poor, since wages are not likely to rise as rapidly as prices, buys them less commodities than it bought

before. This means that, in effect, a part of what the rich hand over to the State in their War Loan subscriptions is really exacted without interest from the poor. For the inflation acts like a proportionate tax upon the expenditure of all classes, and such a tax, of course, hits poor people more severely than rich people. The tendency to currency inflation, therefore, which ordinary methods of war finance promote, thus constitutes a further cause of worsening in the comparative position of the poor. These considerations, even if they stood alone, would suffice to negate the proposition that the proportionate distribution of the objective burden of the revenue, which is proper for peace, is also proper in present conditions.

I now turn to a second and independent objection to this proposition. In order to isolate it, it is convenient to ignore the fact that the present war is an altogether exceptional and cataclysmic event, and to inquire whether the above proposition would be valid in respect of a greatly enhanced governmental expenditure due to some more ordinary cause. It would not, I think, be valid, for the following reason. Presumably, the ground, on which the distribution of the objective burden prevailing in respect of ordinary peace charges is deemed to

be proper, is that it carries with it what we regard as a proper distribution of the subjective ultimate burden of suffering and sacrifice. Let this be so. Then suppose the amount of objective burden all round to be quadrupled. There is reason to believe that a quadrupling of the objective burden on a poor man will increase the subjective burden of sacrifice and suffering laid on him in a proportion higher than that in which the quadrupling of the objective burden on a rich man raises his subjective burden. If the subjective burden of sacrifice caused by taking away ten pounds out of fifty pounds is equal to that caused by taking away 110 pounds out of 500 pounds, the subjective burden caused by taking away forty pounds out of fifty pounds will, I think, almost certainly be greater than that caused by taking away 440 pounds out of 500 pounds. If this be so, it follows that, when, for any reason, the expenses that Government has to meet are greatly enlarged, the proportionate share in which those expenses are borne by the rich ought not to be the same as before, but ought to be greater than before.

This, however, does not exhaust the argument. It will be recollected that, earlier in this book, I distinguished between ways in which the objective burden of war costs can be thrown by the individual

directly shouldering them upon the present or upon the future respectively. Diminution of investment and upkeep of plant struck the future : diminution of consumption and the substitution of work for leisure struck the present. In the light of this distinction, it is natural to frame some such argument as the following : Since poor people are not, as a rule, in a position to draw upon material capital to any appreciable extent, the more largely the objective burden of the extra resources needed by Government is placed upon them, the more likely it is to be met from economy of consumption and of leisure ; whereas, the more largely it is placed upon the rich, the more likely it is to be met by the depletion of material capital. This reasoning, however, ignores the important consideration to which attention was drawn on page 47. The consumption and leisure enjoyed by the poor, since it reacts on their efficiency, is itself an investment of capital. Furthermore, there is reason to believe that it is an investment which, in the long run, will prove more productive than investments in the material capital of machinery and plant. If, in the face of an urgent need, we quadruple the objective burden imposed upon the rich, we shall impoverish the equipment of our factories ; but, if we quadruple the burden imposed upon the poor,

we shall accomplish the much more serious injury of draining away the vital sources of the nation's strength. It follows that, when the aggregate amount of the Government's need is greatly increased, the objective burden involved in satisfying it ought not to be increased equally in respect of all classes, but ought to be increased more largely in respect of the rich than in respect of the poor.

It is possible that the reasoning of the preceding paragraphs may be thought by some to be speculative and inconclusive. I turn, therefore, to a third objection to the thesis that the proportionate distribution of burden which is proper for peace is also proper now—an objection which must, I think, be admitted to possess decisive weight. Why is it that economists do not advocate the placing of practically all the costs of the Government's ordinary peace expenditure upon the shoulders of the very rich and of the rich? It is obvious that, other things being equal, the absorption of a pound from a rich man strikes at much less urgent wants and, therefore, causes much less suffering and real sacrifice than the absorption of a pound from a poor man. It follows that the aggregate amount of sacrifice involved in providing any given revenue would be at a minimum, if the whole of the funds required were lopped off the

few largest incomes enjoyed in the country. In other words, the arrangement best calculated to promote general welfare would be one that so operated as to make equal, not the amount of income taken away, but the amount of income left, to different similarly circumstanced individuals. Why then do economists not advocate this system as regards the ordinary peace revenues of Government? The principal reason is that, in their belief, fiscal arrangements framed on this plan would seriously check saving and certain kinds of work, thus ultimately destroying the source upon which it is levied and preventing that source from yielding *any* relief to other tax-payers. There can be little doubt that this objection is, within limits, valid as regards ordinary taxes that are levied regularly year after year. The expectation of a regular tax of fifteen shillings in the pound on incomes above 5000 pounds would go far to prevent people from bringing such incomes into existence. But the objection is *not* valid as regards special taxes levied on an exceptional occasion for the purpose of financing an unprecedented war. Such taxes do not carry an expectation of continuance and do not, therefore, react upon saving and work in the way that taxes levied in the ordinary course might be expected to do. This point is of fundamental

importance and deserves greater attention than it has hitherto received. It amounts to no less than this : that the main argument, which deters economists from proposing to throw nearly the whole cost of government upon the shoulders of those best able to bear it, is not relevant to the problem of financing a world war. The general effect of this consideration is that a very much larger proportion of the objective burden which the present war imposes upon the community should be laid upon the shoulders of the very rich and the rich than it is proper to lay upon them in respect of the normal expenditure of peace.

If this be granted, the practical inference is plain. The proportion in which the Government has hitherto made use of the method of taxes and the method of loans is one that throws the objective burden of the war costs upon different sections of society in a proportion that does not diverge very greatly from that in which these different sections are accustomed to bear ordinary peace charges. But it has been shown that, in the present cataclysmic and exceptional war, the very rich and the rich ought to bear a proportion of the objective burden very much larger than that. There is one way, and one way only, in which this result can be brought about. The

ratio in which the war is financed with money borrowed from people with large incomes should be much diminished: and the ratio in which it is financed with money collected from them under some form of progressive taxation should be much increased.

II. AFTER THE WAR

IT is not the purpose of this book to engage at length in speculation about the future, but certain remarks of a general kind would seem to be in place. People often write and speak as though the problem of financing the war for the moment was one before which we need not quail, but that, after the war is over, we and our allies and our enemies alike will be threatened with economic disaster. To my mind this type of opinion entirely misconceives the true position of affairs. The thing that *may* prove too much for us is to provide at the moment, in the form in which they are required, the enormous resources needed for the actual conduct of the war. If we succeed in doing this, the economic prospect afterwards, though it may well depress, need by no means terrify us. Let us consider broadly what that prospect is.

First, and most obviously, the National Exchequer will be burdened with an enormous debt—a debt which, it is estimated, will amount at the end of the

current financial year to 2200 millions. On this debt interest will have to be paid, and, to provide the interest, taxes will have to be levied. This is inconvenient and disturbing to industry, but it is not the national disaster that it is sometimes supposed to be. For, after all, the great bulk of our war loans are necessarily subscribed by citizens of this country. The debt due from the Exchequer, therefore, does not represent anything approaching an equivalent debt due from the nation ; and the interest to be paid in respect of it is paid not by the nation to outsiders, but by one part of the nation to another part. To the country as a whole, therefore, the growth of the national debt implies, not a drain upon production, but only a remodelling of distribution. It threatens, not national penury, but only a struggle between people of different grades of wealth as to how much those in one grade shall pay over to those in another. The necessity of such payment—since, as was shown in the preceding section, it will usually be the poor who pay and the rich who receive—is, of course, a sufficiently serious matter. But it is not a thing that makes the nation as a whole poor, and it is capable of being corrected by a readjustment in our system of taxation.

Secondly, when the war ends, a great quantity of property in Belgium, Northern France, Poland and elsewhere will have been destroyed. Furthermore, a great quantity of machinery and plant fitted for ordinary industrial purposes, which, apart from the war, would have been produced during these years by the activity of capital and labour, will not have been produced. There will, therefore, be in existence both in England and elsewhere a smaller supply of capital appliances than would have been in existence if peace had not been broken. Hence, the productive capacity of this country, as of other countries, will be smaller than it would have been. The extent of the injury inflicted upon us in this way must not, indeed, be exaggerated. So far as the war is financed by drawing upon the present, our future equipment is not diminished even below what it would have been ; and, so far as resort is had to resources normally destined to become new capital, that equipment, though smaller than it *would have been*, will not be smaller than it *was before* the war. Still, the blow that has been struck at the growth of capital plainly implies considerable real loss. Furthermore, the full measure of this loss is not to be found by a study of production alone. For, as was shown in the pre-

ceding section, a necessary result of the shortage of capital is to increase the rate of reward which the providers of capital can claim for their services and to diminish the rate which the providers of labour can claim ; and this involves a worsening of the way in which the nation's real income is distributed.

Thirdly, when peace breaks out, there is bound to be a period of difficulty and waste and confusion while industry is readjusting itself to peace conditions. It is true that the period of transition to war conditions, which followed the outbreak in August 1914, was much shorter in duration and much less grievous in effect than economists in general expected. That transition, however, was facilitated by the immediate absorption of large numbers of men thrown out of peace employment into the ranks of the army ; while the transition in the reverse direction, when munition workers and others have to change their employment, will be complicated by the demobilisation of the army. This period of transition, therefore, will obviously call for much care and forethought on the part both of individuals and of the Government, if it is to be negotiated with a minimum of suffering and loss.

Fourthly, after the first few months of transition,

the very destruction and check to new creation of capital, for which the war has been responsible, will be sure to have left open immense fields for profitable enterprise. It is practically certain that, to make good the havoc and the waste of war, there will be a strong industrial boom. This boom, if history is any guide, will generate in many minds an unreasoning sense of optimism leading to much wild investment. The result, some years afterwards, will be failures, crisis and depression. If this danger is to be obviated or mitigated, it is imperative that the Government and the banks should so act as to restrain and keep within reasonable limits the initial peace boom.

What has been said so far of the economic conditions of the future peace is independent of the character of the political aftermath of the war. If the nations, in terror of renewed conflict, spend their strength in frenzied preparation for hostilities on land and sea and air, or if, with reason overborne by passion, they refuse to buy from one another things that they need and that their enemy is skilled to make, then economic recovery and progress will be greatly hindered and delayed. But, if, in lieu of boasts of victory and growlings for revenge, the peace of fact

carries with it peace of feeling, and if this peace of feeling materialises into a life of real international neighbourliness, then the evil that has been wrought in the economic sphere will not be irreparable, and may not even have been wholly vain. The shattered fabric of civilisation may yet be restored—over the graves of our friends.

APPENDIX

TABLE OF PRIVATE ECONOMIES

WHEN a person has decided to effect economies in his personal consumption up to a certain amount, his choice of the particular items in which to economise should be determined by two sets of considerations : the comparative injury done to himself by spending less money on different things, and the comparative benefit conferred on the State by handing over to them money saved on different things. The personal side of the matter does not need discussion here. It is obvious that a man hurts himself more by economising on necessities than on luxuries ; and that to cut down the provision of milk for infants, or of the educational opportunities for young children, is more injurious than to abandon beer-drinking and attendance at picture palaces. The other aspect of the matter is, however, less well understood, and it has, therefore, seemed worth-while to construct a kind of table showing the comparative extent to which different sorts of private economies are also economies from the collective standpoint of the nation as a whole.

I. ARTICLES OF FOOD AND DRINK

1. A sovereign saved in respect of any ordinary non-dutiable article of food or drink means a sovereign's worth, and sometimes a little more than a sovereign's worth, of goods gained for the nation. Economies in respect of articles imported from overseas, such as oranges and bananas, or articles the raw materials of whose manufacture are imported, such as beer, are somewhat more advantageous than economies in home-grown articles. But all economies in ordinary non-dutiable articles of food and drink are worth to the nation at least their full face value.

2. A sovereign saved on an ordinary article of food or drink, part of whose cost is made up, as in the case of sugar, tea, and alcoholic drinks, of customs or excise duties, has, for the nation, its full face value *minus* the amount of the duty.

II. ARTICLES OF CLOTHING

1. A sovereign saved on the purchase or *repair* of ordinary articles of clothing or of footgear means a sovereign's worth (or a little more) gained for the

nation. The fact that reduced purchases of clothes now will necessitate increased purchases after the war does not affect the point.

2. There is some reason to think that a sovereign saved on purchases of woollen garments has more value for the nation than the same sum saved on cotton garments, because wool is used more largely than the other textiles in the manufacture of soldiers' kit.

3. A sovereign saved in respect of costumes made in England, the value of which principally depends on the exquisite finish of highly specialised women workers, has much less than full value to the nation, because those highly specialised workers could not render in any other sphere services nearly as valuable as those which they render in their present sphere.

4. A sovereign saved on the purchase of *old* lace, owned by somebody in this country and not capable of being replaced, has no value for the nation, because it releases no capital or labour.

III. TRAVEL

1. A sovereign saved by refraining from journeys in trains has full value for the nation. The idea that it is "patriotic" to travel because the Government,

in effect, gets the fares is a fallacy; the running of trains is, *in all circumstances*, a real cost to the nation, because it uses up capital and labour.

2. A sovereign saved by travelling third class instead of first class has less than full value for the nation, because the real cost of carrying a first-class passenger differs much less from that of carrying a third-class passenger than the price of a first-class ticket differs from that of a third-class ticket.

3. A sovereign saved by refraining from journeys in motor cars and taxi-cabs has nearly full value for the nation, because it releases petrol and chauffeurs' labour. It has not quite full value unless the motor car or taxi-cab can itself be converted to war service.

IV. HOUSE AND ESTATE

1. A sovereign saved in respect of the building, repair and painting of a house or a boat, or of the purchase, repair and upkeep of a motor car or motor bicycle, or of the purchase of furniture or fuel, has full value for the State.

2. So also has a sovereign saved by the dismissal of chauffeurs, ordinary men servants (except in respect of that part of the saving which consists in

the man-servant tax), general labourers, and general women servants without specialised training but physically fit for industrial work.

3. A sovereign saved by the dismissal of servants, whose value is chiefly due to highly specialised qualities of little utility for war needs—a highly-skilled flower-gardener, an artist in cookery, an exceptionally competent nursery maid or governess, a court musician or a court jester—has much less than full value for the State.

4. A sovereign saved by economy in the use of water, gas and electric lighting has somewhat less than full value for the State, because, though the coal and labour utilised in producing these things can be employed for war purposes, the large and valuable plant which is mainly responsible for them cannot easily be so employed.

V. RECREATION

1. A sovereign saved in respect of game preserving and shooting has full value for the State.

2. A sovereign saved by non-attendance at concerts, theatres and lectures has much less than full value for the State, because the musicians, actors and orators, who would be set free thereby,

are highly-specialised persons, probably incapable of rendering to the Government a service nearly as valuable as that which they render to the public. In a smaller degree the same consideration holds good of economies in books and newspapers.

3. A sovereign saved by buying cheap seats instead of expensive seats at concerts, theatres and lectures has very little value for the State, because the real cost of providing the expensive seats exceeds that of providing the cheap ones by much less than the excess of the price charged.

4. A sovereign saved on tobacco and cigars has full value for the State in respect of that part of the cost which is not due to the customs duty.

5. A sovereign saved by refraining from betting and gambling has practically no value for the State, because it releases practically no capital and labour.

VI. SALARIES, PENSIONS AND CHARITIES

.. A sovereign saved by reducing the salaries or wages of employees *whom we continue to employ*, whether they be members of Parliament or housemaids, by cutting down pensions that we have been accustomed to provide, or by reducing our sub-

scriptions to hospitals or charities, has no value whatever for the State. All that happens is that a sovereign is transferred to us from other people, and no real economy is directly effected either in goods or in services.

